

An Assessment of the Impact of Internal Auditing on the Financial Management of Local Government: A Study of Katagum Local Government Area of Bauchi State

Ibrahim Aliyu Gololo¹

¹Department of Accounting, Faculty of Social and Management Science, Bauchi State University Gadau, Bauchi, Nigeria

Correspondence: Department of Accounting, Faculty of Social and Management Science, Bauchi State University Gadau, Bauchi, Nigeria, Tel: +234 8036312938/8026903796, Email: aliyugololo2@gmail.com

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Abstract

This study examines the impact of internal auditing on the financial management of local government, with particular reference and attention to the katagum local government area of Bauchi state. Staff of internal audit, finance and account constitutes the population of the study from which a sample size of forty (40) respondents was selected based on convenience sampling method. Chi-square (χ^2) method was adopted as a statistical tool of data analysis to analyze the collected data. The result indicates that internal audit impact positively and significantly on the financial management of Katagum local government. It is recommended that internal audit unit of the Katagum local government should be allowed to fully access all the local government account and records, properties and investments files to carry out their duties diligently. Internal audit unit staff should also be allow attending workshops, seminars, conferences in order to broaden their knowledge. Adequate independence should be given to the unit to discharge their duties without due interference and regular review of the whole system of internal control in the local government should be carried out.

Keywords: Internal Auditing, Financial Management, Internal Control, Katagum Local Government Council.

1. Introduction

Internal auditing is seen as the independent appraisal of an organization of the accounting, financial and all other operations as a mechanism for protective and advisory services to management of an organization.

Internal Auditing is an audit function which is being used by local governments in Nigeria as a part of their overall system of internal control. Such auditing is carried out by local government employees who are accountants and responsible to local government financial management. The activities of internal auditors were originally intended to verify secrecy and dependability of the accounting systems, data and information [Dandago 2011].

However, every ministry, agency, parastatal, state and local government is expected to establish an internal audit unit in Nigeria. The internal audit unit is responsible for the audit of all financial transactions carry out in such organizations. The units do so by carrying out a continuous examination of all accounting books and records maintained in the local government with a view to checks or detect fraud and correct errors. It is concerned with the examination of the system and procedure in place so as to ensure their conformity with the set down regulations, as the case may be, that the system of internal control is adequate and that it is continuously operating in accordance with government financial regulations.

It is the job of internal auditor to ensure that all financial transactions are in accordance with the approved regulations and that adequate system of security exists in the establishment (Millichamp, 2004). Internal auditor should be independent and directly responsible to the chairman of the local government. The internal audit unit should be properly organized, adequately staffed and equipped to be able to effectively perform its functions.

Adeniyi, (2010) & Dandago, (2011) are of the view that internal audit should include periodic surprise cash survey in all sections of the local government, checking of revenue collectors' receipts, cash books, receipt books and bank

tellers, as well as, inventory verification of the store and maintenance of assets register and ledgers for the purpose of easy location and identification of the assets of the organization.

To achieve sanity in government business, the federal government of Nigeria introduced the new civil service rules to ensure that civil servants including local government staff are professional, productive and responsive to the socio-economic needs of Nigeria, this will in turn revamped and restructure the local government administration to enable it perform its role of promoting, coordinating and implementing community services, enhances grassroots participation in governance and maximizing the use of local resources. Therefore, government came up with financial instruction and guidance circular in 1979 mandating all local governments in Nigeria to set up internal audit unit in the local government. This is more so because of the large amount of money given to the local governments from the federation accounts that is (20%) of the total revenue generated from monthly federation account and 10% of the state internally generated revenue and also the internally generated revenue [IGR] of the local government.

Despite the issuance of the financial instruction circular to local governments the behavior and attitude of operation of most local government staff most of the internal audit unit were not functional and operational.

In this paper we seek to shed more light on the issue of whether internal auditing has impact on the financial management of local government council of Nigeria. The objective of this study is to assess the impact of internal auditing on the financial management of katagum local government council and to specifically find out the role auditing play in ensuring adequate financial management in the local government council of Nigeria.

To achieve the stated objective, the null and alternate hypotheses are formulated.

H₀: That internal auditing has no significant impact on the financial management of katagum local government council.

H₁: That internal auditing has significant impact on the financial management of katagum local government council.

The rest of this paper will be in the following order. Section two is the literature review, followed by section three which is methodology, and section four and five are data analysis and discussion, conclusion and recommendations.

2. Literature Review

Myriad of definition exists on internal auditing, internal audit is seen as an independent appraisal function established by the management of an organization for the review of operations as a service to management. (Adeniyi 2010) sees auditing an independent examination of and the expression of an opinion on the financial statements of an enterprise by an appointed auditor, in accordance with his terms of engagement and the observance of statutory regulations and professional requirements.

However, Institute of internal Auditors [IIA] define internal auditing as a periodic examination of the books of account and records of an entity carried out by an independent third party [auditor], to ensure that they have been properly maintained and accurate.

Chambers: (1987) defined internal auditing as “an independent appraisal function within an organization for the review of system of control and the quality of performance as a service to the organization. It objectively examines, evaluates and reports on the adequacy of internal control system to the proper economic, efficient and effective use of resources”.

Internal audit is considered as an additional safeguard for proper financial control in the public sector.

The internal auditor is responsible for the audit of all financial transactions by carrying out a continuous examination of all accounting books and records maintained in the organization with a view to checking or detecting fraud and correcting errors. It is concerned with the examination of the system and procedure in place so as to ensure their conformity with the regulation that the system of internal control is adequate and that it is continuously operating in accordance with government regulations [Dandago 2011].

It is the job of internal auditor to ensure that all financial transactions are in accordance with the approved regulations and that adequate system of security exist [Millichamp, 1990]. Internal auditor should be independent and directly responsible to the chief executive. The internal audit unit should be properly organized, adequately staffed and equipped to be able to effectively perform its functions.

(Millichamp, 2004). Internal auditor should be independent and directly responsible to the chief executive. He however, identifies four [4] types of internal.

2.1 Types of Internal Audit

Adeniyi [2010] stated that internal audit have been categorized in to Five [5] types.

2.1.1 Social Audit

The idea of this audit portray the fact that company does not exists in isolation, the relationship extend to the company shareholders, employees, customers, community and the general public. Matters within the scope of social audit includes staff incentives, staff bonuses, staff welfare package, recreation facilities and staff retirements arrangements, pricing policy, products safety and quality control etc

2.1.2 Value for Money Audit

This audit has become common and fashionable in the recent years. It is a type of internal audit in the public sector such as the work of local governments, state and federal government and departments. The purpose of conducting VFM audit by the organization is to investigate the operating system in the organization and evaluates whether the objectives of the system is being achieved and ensure the resources of the organization is being utilized efficiently and economically and if there is unnecessary spending to be checked.

2.1.3 System Audit

This is an audit of internal control, it is designed to evaluate the internal control system of an organization to ensure that the resources are being managed effectively and efficiently and that information provided is accurate. System audit examines the effectiveness and application of the two most important test namely compliance and substantive test to the organization.

2.1.4 Transactions Audit

This audit is sometimes refers to probity or financial audit. It is mainly apply to ensure that the financial assets of the organization are safeguarded. Example by physical inspection of stock and cash in hand.

2.1.5 Management Audit

CIMA [2015] define management audit as an objective and independent appraisal of the effectiveness of managers and the effectiveness of corporate structure in the achievement of the company objectives and policies.

Herbert L. [2014] emphasized that the function of management audit is to identify existing and potential management weaknesses within an organization and recommend possible ways of rectifying the problems.

2.2 Internal Auditing At the Local Government Level

The implementation guideline on the application of civil service reforms in the local government service (1998) as cited in Andy (2001) provided that; there shall be established in each local government, an internal audit unit, headed by a qualified and professional accountant to provide a complete and continuous audit of the accounts, and records of revenue and expenditure. The internal auditor of each local government shall directly be responsible to the accounting officer and the Auditor General of the local government council, and therefore he shall report monthly to the accounting officer, as well as to the Auditor General of the local government council, on the true progress of internal audit. He shall also issue special reports, if necessary, where, in his opinion, the attention of the Auditor General of the local government council should be drawn. The main objective of internal auditing at local government level is; to promote accuracy and reliability in accounting and operating data, to safeguard government resources against waste, fraud, and inefficiency, to measure the extent of the operating departments' compliance with government policy, to evaluate the overall efficiency of the operating functions (Schilit, 1997). (Andy, 2001) is of the view that internal auditors at local government should ensure that all officers whose duties involve the handling of local government funds are adequately bonded, ensure that the computation and casting have been verified and are arithmetically accurate, ensure that all payments have been entered in the Departmental Book Account (DBA).

From the foregoing, we can actually understand that the purpose of internal auditing is not to discover fraud, as some people assume, but to review and evaluate the activities of the organization with a view to expressing an opinion on the efficiency and effectiveness of management as well as adequacy of internal control within the organization. A properly conducted internal audit is expected to reveal errors, strengths or weaknesses of the internal control system of the organization.

2.3 Scope and Objective of Internal Auditing

According to Buttery and Simpson (1986), the scope and objective of internal audit depends upon the responsibilities assigned to the internal auditor by the management, the size and structure of the enterprise and the skills and experience of the internal auditor. Millichamp (2004) and Brown, (1999) identifies the common areas covered by internal auditing which include among others; reviewing the internal control system with a view to determining its adequacy and effectiveness, reviewing compliance with government regulations and accounting rules and standards, checking compliance with policies and procedures, safeguarding the asset of the organization, prevent and detect errors, frauds and theft, appraising the effectiveness and efficiency in the use of resources, ensuring that the goals and objectives of the organization are attained, making recommendations on improvement in the operation of the organization, acting as in-house consultant on control matters. The Financial Memorandum (1999), however, states that an internal audit unit shall be responsible for carrying out an independent appraisal of the accounting, financial and other processes of the local government with the objective of assisting to protect the assets and interests of the local government through a process of continuous examination of its activities, securing a continuous operation of a sound internal control system within each department, reviewing, and where necessary, making recommendations for improvement of the system, controls and procedures in the local government with a

view to ensuring that they operate effectively, monitoring the use of resources in the pursuit of defined objectives of the local government. The Memorandum also stated that; the internal auditor shall report to the Chairman every quarter of the year on the progress of the internal audit work. The reports shall specifically indicate the internal auditor's finding with respect to; the collection of revenue, the protection of physical and other assets of the local government, the current and capital expenditure, the efficiency and effectiveness of system control and procedure, the use of resources of the local government in achieving its objective, any instance of fraud or misappropriation observed by the internal auditor should be revealed to the Chairman's attention.

2.4 Benefit of Internal Auditing

The benefits that may be derived in establishing internal audit are numerous. Chambers and Selim (1988), observes that the setting up of an efficient and effective internal audit department involves huge cost in form of salaries for personnel, stationery, travelling allowances and other departmental overheads. But if analyzed critically, the benefits of an internal audit unit to an organization, be it private or public, outweighs the cost of its maintenance. Some of the benefits that may accrue to organizations with good internal audit departments include among others; improved efficiency, creates cost control, which acts as a deterrent to inefficiency, waste and fraud, the internal audit department serves as a 'pool' from which high caliber staff can be seconded to other units within the organization to fill management positions, internal audit make the work of external auditors easier, training and experience acquired by internal auditors on the job combine to provide a secure foundation for career advancement. From the foregoing it is clearly understood that the benefits of internal audit are enormous to organizations.

2.5 Problems of Internal Auditing

This research work identifies some of the problems that can hinder the effective performance of internal audit unit at local government level are:

2.5.1 Lack of high degree of independence: The fact that the internal auditor is an employees of the organization does not allows him to perform his work objectively with an independent mind the internal auditor should therefore, not only be independent in mind but most also seen to be in independent.

2.5.2 Lack of effective communication between Auditor and Management: Changes in policy statement and procedures are not usually communicated to the internal audit department to enable them enforce the changes. This affect operations of audit unit.

2.5.3 Giving internal auditor assignment with predetermined result by the management: The management sometimes gives assignment to the internal auditor and they indicate the result expected from him this does not give the internal auditor freedom to reach a fair conclusion as his hands would be tight to the predetermined results.

2.5.4 Negative attitude of employees toward the internal auditors: Most employees do fear or hate the internal auditors and his staff they usually regard the auditors as "blood bound" or fault finding chairman who are always going round the local government to fault peoples work.

2.5.5 Lack of adequate and appropriate facilities to the internal audit unit is another problem that affects the audit work in the local government.

2.6 Possible Suggested Solutions to the Problems of Internal Auditing

These are the solutions to the problems and if implemented they will cushion the effects of the problems. The management is therefore expected to:

- Provide adequate and appropriate working facilities to the internal audit unit.
- Give internal audit staff total independence for them to discharge their duties without due interference.
- Allow internal audit unit to report findings and recommendation to the management regularly.
- Allow internal audit unit to check that no one person is solely responsible for the entire process end to end, without effective checks and balance. The person, who documents the transaction, should not be the same person who conducts the transactions.
- Allow audit unit to attend workshops, seminars conferences in order to broaden their knowledge, increase their skills to impact on the local government administration.

3. Research Methodology

This research work employ the use of survey research design, this in turn enable the researcher to use primary method of data collection and the tools utilized for this purpose is questionnaire that enable the researcher present questions to internal audit and finance and accounting staffs of katagum local government. Primary data is an important method of data collection. (Ngagi, 1999) defined primary data as at the data collected directly from people. The most common tools of collecting primary data include questionnaire, interview and observations.

The targeted population consists of all internal audit staffs and finance and account staffs of the katagum local government but because of the constraints mentioned in limitation of the study the researcher selected 40 staffs. The selected sample was based on the personal judgment of the researcher.

3.1 Questionnaire Design

Introductory letter were provided at the beginning of the questionnaire. It consisted of two sections. Section A is related to demographic statistic and section B consist of questions (Yes or No questions) relating to the subject of the study.

3.2 Technique of Data Analysis

The statically tool that were used in chapter four to present and analyzed data include simple percentages the use of percentages was very much recommended by Asika, (2004), tables for data presentation and chi-square (X^2) for data analysis.

- i. Simple percentage is given by = $\frac{\text{Number}}{\text{Total}} \times 100$
- ii. Chi-square (X^2) is given by the formula $X^2 = \sum_{1=i} \left(\frac{fo-fe}{fe} \right)$
- iii. Where: X^2 = chi-square \sum =summation
Fe= expected frequency Fo= observed frequency
and fe(expected frequency) is given by= (row total X column total)
- iv. The degree of freedom necessary for the application of chi-square (X^2) is determined thus; $df = (r - 1) (c - 1)$
Where: r = number of rows. c = number of columns
- v. The level of significant used is 0.05 or 95%
- vi. Decision rule: To reject the null hypothesis if the calculated chi-square (X_c^2) is less than the tabulated chi-square (X_t^2). This is, if $X_c^2 < X_t^2$ reject H_0 and accept H_+ .

3.3 Testing Hypothesis

In testing the hypothesis, the chi-square (X^2) test was employed, this is because it could be used for both small and large samples. The chi-square test is a measure of the discrepancies exiting between the observed frequencies and expected frequencies of one or more variables.

H₀: That there is no significant impact of internal audit on the financial management of katagum local government.

H₁: That there is significant impact of internal audit on the financial management of katagum local government.

In line with the hypothesis question, question 11 of the questionnaire was used to test the hypothesis and the responses are as follows:

Table1 Contingency Table for Testing of Hypothesis

Options	Number of respondents		Total
	Internal audit staff	Finance and account staff	
Yes	9	28	37
No	1	2	3
Total	10	30	40

Source: questionnaire 2016

Computation of the test using the chi-square (X^2)

$$\begin{aligned}
 X^2 &= \sum_{1=i} \left(\frac{fo-fe}{fe} \right) \\
 &= \frac{37 \times 10}{40} \\
 &= 9.25 \\
 &= \frac{3 \times 10}{40} \\
 &= 0.75 \\
 &= \frac{37 \times 30}{40} \\
 &= 27.75 \\
 &= \frac{3 \times 30}{40} \\
 &= 2.25
 \end{aligned}$$

4. Analysis and Discussion of Results

Table 2: Chi-Square Table for testing hypothesis

OF	EF	(OF-EF)	(OF-EF) ²	$\frac{(OF - EF)^2}{EF}$
9	9.25	-0.25	0.0625	0.0068
1	0.75	0.25	0.0625	0.0833
28	27.75	0.25	0.0625	0.0022
2	2.25	-0.25	0.0625	0.0278
		0		$X_c^2 = 0.1201$

$$X^2 = \sum \left(\frac{OF - EF}{EF} \right)$$

$$X_c^2 = 0.1201$$

$$X_t^2 = 3.841$$

While taking @ (level of significance) =0.05

Degree of freedom =1

DECISION $\xrightarrow{3.841 > 0.1201}$

From the above- calculated chi-square (X_c^2) is 0.1201 which is less than the tabulated Chi-square (X_t^2) 3.841. i.e. $X_c^2 < X_t^2$.

Since the calculated Chi-square is less than the tabulated Chi-square we can now reject the null hypothesis which says that there is no significant impact of internal audit on the financial management of katagum local government and accept the alternate hypothesis which says that there is significant impact of internal audit on the financial management of katagum local government.

4.1 Summary of Findings

This research work assessed the impact of internal auditing on the financial management of local government with focus on the Katagum local government council. Therefore, it is the responsibility of the management of the local government to established internal audit unit to enable it, prevents irregularities on the financial management of the local government and ensure the review of the audit manual and guidelines in order to ensure effective control and management of the local government finances so as to prevents irregularities as well as to ensure that errors are detected, prevented and frauds avoided in the local government council.

Summarily internal audit unit is an independent appraisal unit which carries out an activity that relates to local government finances to review its operations and ensures that all expenditures are in line with laid down rules and regulations provided by the financial management. Based on the previous summary we can actually say that internal audit assists local government management to effectively discharge their responsibility.

However, the scope and objective of internal audit unit may vary depending on the need of the local government; the quality of staff and the level of independence accord to the audit staff to enable them discharge their responsibilities.

5. Conclusion and Recommendation

In conclusion, is important to state that, the existence of an internal audit unit in any local government cannot be over emphasized; as such there is every good reason for the management to established one. Internal audit impact significantly and positively on the financial management of katagum local government council that is to say that there is effective and efficient financial management in the katagum local government council as a result of internal audit existence.

Finally, internal audit staff needs to be independence of management of the local government for them to effectively and efficiently discharge their responsibilities.

This study therefore recommends that Internal audit unit should be allowed to fully access all the local government accounts and records, properties and investments files of the local government in order to review and appraise them to ensure that the laid down, procedures of financial management are being complied with and they should be independence from management for them to discharge their duties without due interference and finally staff of the unit should periodically attends workshops, seminars, conferences related to auditing in order to broaden their knowledge, increase their skills to impact on the local government administration.

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Appendix A

Sample Questions: Section A: Demographic information

Instructions: you are kindly requested to tick just one option as it relates to you.

1. Gender: (a) Male (b) Female
2. Marital Status: (a) Single (b) Married (c) Divorced (d) Separated (e) Widowed
3. Educational Qualification: (a) PhD (b) PGD/Masters (c) HND/BSc (d) ND/NCE (e) SSCE
4. Department/unit:.....
5. Year of experiences (a) 1-5 (b) 6-10 (c) 11-15 (d) 16-20 (e) 21 and above

Section B: Questions Relating to Internal Auditing

1. Do you think the internal audit unit is important to the local government?
YES ☐ NO ☐
2. Do you think the internal audit unit verifies all payments and receipts made by the local government?
YES ☐ NO ☐
3. Are internal audit unit being allowed to control the local government finances?
YES ☐ NO ☐
4. Did the internal audit unit perform their duties in accordance with laid down guideline, rules, and procedures?
YES ☐ NO ☐
5. How effective is internal audit unit of this local government?
Very effective ☐ effective ☐ ineffective ☐
6. Do you think other local government staffs accord cooperation to internal audit unit interns of their investigation?
YES ☐ NO ☐
7. Do you believe that the internal audit is back bone of the detection of fraud and errors in the local government?
YES ☐ NO ☐
8. Are leaders in the local government allowed the internal audit unit to carry out their work without due interfering?
YES ☐ NO ☐
9. Did internal audit unit made financial management of this local government effective?
YES ☐ NO ☐
10. Is there any relationship between internal auditing unit and irregularities in this local government?
YES ☐ NO ☐
11. Does internal auditing impact on the financial management of the katagum local government?
YES ☐ NO ☐
12. Are there any benefits derived from internal audit unit of local government?
YES ☐ NO ☐

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